THE HONORABLE MARSHA J. PECHMAN

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

COSTCO WHOLESALE CORPORATION, a Washington corporation,

Plaintiff,

v.

ROGER HOEN, VERA ING, and MERRITT LONG, in their official capacities as members of the Washington State Liquor Control Board,

Defendants,

and

WASHINGTON BEER AND WINE WHOLESALERS ASSOCIATION, a Washington non-profit corporation,

Intervenor Defendant.

NO. CV04-0360P

COSTCO'S TRIAL BRIEF

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CONTENTS

I. INTRODUCTION 1

II. PROCEDURAL POSTURE 2

III. THE TWENTY-FIRST AMENDMENT TEST 4

IV. THE RESTRAINTS ARE NOT INTENDED TO REDUCE ALCOHOL ABUSE OR SERVE OTHER CORE CONCERNS UNDER THE TWENTY-FIRST AMENDMENT 4

A. Defendants Must Show At Least An Intended Purpose for the Restraints 5

B. History Shows No Intent to Raise Prices to Reduce Abusive Consumption 6

1. Consistent with the Original Statute, the State Has For Years Sought to Serve Overall Demand and to Provide Reasonable Prices 7

2. The Restraints Were Not Intended to Promote Temperance 9

3. The Most Reasonable Inference From the Restraints Does Not Satisfy the Twenty-first Amendment 13

V. THE RESTRAINTS ARE NOT CLOSELY CONNECTED TO, AND DO NOT MEANINGFULLY FURTHER, ANY CORE PURPOSE 14

A. If Affecting Consumer Purchasing Decisions Was the Point, Retail Pricing Would be Directly Regulated and Monitored 14

B. Inconsistencies Overwhelm The Post Hoc Litigation Rationale 16

C. The Restraints Have Not Had a Meaningful Impact on Abusive Consumption, and Defendants Have Not Cared 17

VI. THE BALANCE STRONGLY FAVORS THE FEDERAL INTERESTS 19

A. The Strong Federal Interests in the Sherman Act and the Supremacy Clause 20

B. The State Endorses the Importance of the Sherman Act 20

C. The Restraints Significantly Damage Competition and Consumer Welfare ... 21

D. Washington Tempers Temperance in Furtherance of Objectives Less Substantial than the Sherman Act 21

E. Obvious Less Restrictive Alternatives Exist 22

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F. Defendants' Argument Proves Too Much 23

VII. EVIDENTIARY ISSUES 24

VIII. CONCLUSION 25

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I. INTRODUCTION

The Court has determined that the challenged restraints on wine and beer distribution (except perhaps the one banning sales between licensed retailers) violate the Sherman Act and are unprotected by state action immunity. Thus, defendants will proceed first at trial and will attempt to satisfy their demanding burden to prove that: 1) the restraints were intended to serve "core" state concerns authorized by the Twenty-first Amendment (intent); 2) the restraints are closely connected to and effectively serve that purpose (fit); and 3) the extent to which the restraints are necessary and serve such purposes outweigh the important federal interests of the Sherman Act (balance). Having already agreed that the challenged restraints cause Washington consumers to overpay for beer and wine, the members of the Liquor Control Board would have this Court and the citizens of Washington believe that it is State policy for distributors to make excess profits. The reason, they say, is that by driving up prices to consumers this policy causes people to drink less, which incidentally may reduce abuse of alcohol. This "rationale" was invented for purposes of this lawsuit and bears no relationship to the creation or administration of the laws that Costco is challenging. The belatedly articulated position of the Liquor Control Board ("LCB") is not a policy created by the Legislature, offends common sense, is not applied by the LCB in operating its own liquor stores, is abhorrent to federal competition law, and does not promote public health.

Defendants do not dispute that the Washington system seeks to serve overall "lawful demand" for alcohol, including wine and beer. Pretrial Order Admitted Facts 3, 11, 12 (Dkt. No. 122). They argue that the State has a paramount concern with reducing abusive consumption and that, even if not the intended purpose, the restraints might tend to reduce overall consumption and, perhaps, abusive consumption. However, their expert witness, Professor Chaloupka, does not claim that the restraints have meaningfully reduced abusive consumption in Washington. Ex. 580 at 16-17 (admitting lack of studies and presenting estimates only of small effect on overall consumption, not abusive consumption). And defendants will concede that in both adoption and application of the restraints there has been no mention, much less study, of their effects on abusive consumption. The State instead has frequently undertaken actions, including reducing

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the retail pricing of wine in state stores, that facilitate, maintain, or even increase overall consumption (without attempting to measure impacts on abusive consumption). Finally, even if the restraints have an incidental effect on abusive consumption, the State cannot satisfy its burden of showing that this effect is worth the cost of overcharging millions of Washington consumers who use alcohol responsibly, particularly when the fruits of that overcharge go not to the State treasury (where they could be used to directly target alcohol abuse) but into the pockets of distributors who have a vested interest in trying to sell more alcohol.

In short, the trial will establish what the Court already knows from common sense and everyday experience. Prohibition taught the lesson that trying to end abusive consumption by a general reduction in overall consumption was ineffective, unpopular, and had unintended consequences. The Legislature and the LCB in fact have embraced that lesson and have sought in numerous ways to satisfy overall demand, keep prices reasonable, and address abuse through education and restrictions directly on abusers and on sales to abusers. The Legislature never intended what defendants now propose for purely litigation purposes--to penalize responsible consumers in the hope of having some indirect and minor effect on abuse.

II. PROCEDURAL POSTURE

As a result of the Court's summary judgment rulings of December 21, 2005 (Dkt. No. 113; "First Antitrust Order"), and March 7, 2006 (Dkt. No. 119), the Court has determined that the following are per se, hybrid restraints of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1; are not saved by the state action immunity doctrine articulated in *Parker v. Brown*; and are preempted under the Supremacy Clause and unlawful under 42 U.S.C. § 1983:

- the prohibition on volume discounts to retailers (RCW 66.28.180(2)(d) & (3)(b); RCW 66.28.170; WAC 314-12-140(3));
- the prohibition on variations in prices offered to different retailers (RCW 66.28.170; RCW 66.28.180(2) & (3); WAC 314-12-140; WAC 314-20-100(2), (4) & (5); WAC 314-24-190(2), (4) & (5));

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- the prohibition on extending credit to retailers (WAC 314-13-015; RCW 66.28.010; WAC 314-20-090; WAC 314-12-140(3));
- the requirements that prices from manufacturers and distributors be publicly posted and that no sales be made at other than the posted prices (RCW 66.28.180(2)-(3); WAC 314-20-100(2) & (5); WAC 314-24-190(2) & (5));
- the requirement that prices be posted in advance of their effective dates and be held for a full month once posted (WAC 314-20-100(2) & (5); WAC 314-24-190(2) & (5));
- the mandatory 10% minimum mark-up on price from manufacturer to distributor and distributor to retailer (RCW 66.28.010(2); RCW 66.28.180(2)(d) & (3)(b));
- the requirement that distributors sell at "delivered" pricing even if the retailer pays the freight or picks up the goods (RCW 66.28.180(2)(h)(ii)); and
- the prohibition of central warehousing by retailers (RCW 66.28.180(2)(h)(ii); RCW 66.24.185(4)) and the annual case limitation for shipments to retailers from a bonded warehouse (WAC 314-24-220(5)).

In its March 7 Order (Dkt. No. 119), the Court reserved ruling on whether the prohibition of retailer-to-retailer sales (RCW 66.28.070; WAC 314-13-010) is irrevocably in conflict with federal antitrust law and unshielded by the state action and Twenty-first Amendment immunities. The Court has allowed defendants to respond to Costco's supplemental summary judgment brief (Dkt. No. 115). Therefore, Costco will not add anything further regarding retailer-to-retailer sales at this time, and stands ready to prove its entire case on that restraint if necessary.

The March 7 Order also granted partial summary judgment on central warehousing, and in its pleadings on that issue, Costco had included the related restraint on annual shipments to retailers from a bonded warehouse. Costco's Motion for Summary Judgment on its First Claim and Related Portion of Third Claim (Dkt. No. 70) at 3, last bullet (September 2, 2005); Costco's Reply Memorandum Motion for Summary Judgment on its First Claim and Related Portion of Third Claim (Dkt. No. 105) at 7 (October 14, 2005). Costco believes that the Court's March 7

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order includes the limitation in WAC 314-24-220(5), and has included that section in the list above. If the Court disagrees, Costco also will prove its entire case on that restraint.

Because the only issue left for resolution is a governmental defense, Costco objects to participation by the distributors' private trade association. Costco does not dispute that the association obtained adoption of the restraints and that they further its members' private interests, but the association has no standing to make arguments under the Twenty-first Amendment.

III. THE TWENTY-FIRST AMENDMENT TEST

Last year the Supreme Court decisively rejected the contention that the Twenty-first Amendment authorizes states to do whatever they see fit as long as they invoke "temperance." *Granholm v. Heald*, 125 S. Ct. 1885, 1903 (2005). *Granholm* and its predecessors establish that the Amendment does not trump important federal free market interests in the Commerce Clause and the Sherman Act. Accordingly, this Court has recognized that it must: 1) "examine the *expressed* state interest" for the restraints "and the closeness of that interest to those protected by the Twenty-first Amendment;" 2) "examine whether, and to what extent, the regulatory scheme serves its *stated* purpose;" and 3) "balance the state's interest (to the extent that interest is actually furthered by the regulatory scheme) against the federal interest in promoting competition under the Sherman Act." First Antitrust Order at 15 (citing *TFWS, Inc. v. Schaefer (I)*, 242 F.3d 198, 213 (4th Cir. 2001)) (emphasis added); *see* Order on Plaintiff's Motion for Partial Summary Judgment on Second Claim (Dkt. No. 112; "Direct Shipment Order") at 5.

IV. THE RESTRAINTS ARE NOT INTENDED TO REDUCE ALCOHOL ABUSE OR SERVE OTHER CORE CONCERNS UNDER THE TWENTY-FIRST AMENDMENT

The Court first must examine whether "the expressed state interest" in the restraint, *TFWS, Inc. v. Schaeffer (II)*, 325 F.3d, 234, 236 (4th Cir. 2003), is "so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 275-76 (1984) (internal quotations omitted).

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A. Defendants Must Show At Least An Intended Purpose for the Restraints

Specific findings of an express or at least intended purpose for the restraints, rather than general declarations as to the system as a whole, are required to establish the connection to a Twenty-first Amendment core concern. *See 324 Liquor Corp. v. Duffy*, 479 U.S. 335, 351 n.13 (1987); *Stroh Brewery Co. v. Walp*, 1994 U.S. Dist. LEXIS 21458, *24 (M.D.Pa. April 4, 1994) (defendants "cannot rely on the broad purposes of the Code"). Defendants must connect the purpose of the particular restraints to Twenty-first Amendment objectives. *TFWS I*, 242 F.3d at 213. "[M]ere assertion is not enough; the State, having the burden of proof on the Twenty-first Amendment defense, needs to present evidence of its alleged interest." *Bainbridge v. Turner*, 311 F.3d 1104, 1114 n.16 (11th Cir. 2002).

Judicial respect for state action, especially state action that contravenes important federal constitutional and statutory policies, is not warranted on the basis of the accidental or unintended effects of that action. *See FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992) ("federalism" not served by a rule that "essential national policies are displaced by state regulations intended to achieve more limited ends" than those asserted). It is not enough that a state has "acted through inadvertence"; the state must show "that particular anticompetitive mechanisms operate because of a deliberate and intended state policy." *Id.* at 636-37; *see id.* at 634 ("deliberate state intervention"). The purpose must be more than the belated and expedient expression of a litigation defense. Thus, in rejecting a defense that New York's alcohol pricing system had "the *effect* of raising prices" and thus reducing consumption," the Supreme Court looked at regulatory history, and concluded that temperance was not really the intended purpose. *324 Liquor*, 479 U.S. at 351 (the New York court had found that the purpose was actually to protect small retailers). Even though the relevant statutory section gave lip service to promoting temperance, the Supreme Court found that this was "not supported by specific findings." *Id.* at 351 n.13.

The State agrees with this demanding standard, at least when it wants to see another state's restraint on competition struck down despite the state's contention that it was logical to

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infer that the restraint tended to reduce consumption by minors and tax evasion. In *Granholm*, the two leading wine-producing states, California and Washington, authored an amicus brief for a number of other states. Ex. 313 (Brief of Amici Curiae for the States of California, Washington, New Mexico, Oregon, and West Virginian in Support of Respondents, *Granholm v. Heald* ("CA/WA Amici Brief")) at 25 (Sept. 23, 2004) (citing *324 Liquor's* standard of substantiation). Where interests are speculative and unsubstantiated, said the State, they "fail even to present a conflict between the Twenty-first Amendment" and the federal interest. *Id.*

Defendants cannot prove that the restraints, either individually or in the aggregate, were intended to increase wine and beer prices to accomplish a reduction in overall consumption in the hope of reducing abusive consumption. For that reason alone the Court can conclude that the Twenty First Amendment does not save the illegality of the restraints under the Sherman Act.

B. History Shows No Intent to Raise Prices to Reduce Abusive Consumption

Defendants will not present the Court with direct expression by the Legislature, or even the Board, that one or more of these restraints was intended to restrain or even effective at reducing abusive consumption. Indeed, in over seventy years there have only been a few stray comments by staff or individual board members even considering whether to seek increased prices to reduce consumption. Defendants are left to argue that, because the restraints raise prices and costs to many private retailers, the restraints must have been intended to cause increased prices to consumers and to cause some minor decline in overall purchases of wine and beer, including purchases by those who would abuse these products. Strained enough on its face, the inference is unconnected to reality. First, the expressed (rather than inferred) State purposes actually are to serve overall demand and keep prices lower rather than higher. Even before it was generally accepted that moderate consumption of wine is more healthful, there were numerous examples where the Legislature or Board have taken actions to maintain or increase consumption. Second, other purposes (unrelated to temperance or public health) were instead

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expressed in the creation and maintenance of the specific restraints, including protecting the purely private commercial interests of distributors

1. Consistent with the Original Statute, the State Has For Years Sought to Serve Overall Demand and to Provide Reasonable Prices

When Washington enacted the Liquor Act in 1934, there was no mention of high prices as a way to promote temperance. The Act's statement of intent noted only that it was a general exercise of the State's police power "for the protection of the welfare, health, peace, morals and safety of the people." Ex. 401 at 3, Sec. 2; RCW 66.08.010. The 1933 Liquor Control Commission that authored the Act sought to assure availability of alcoholic beverages "at reasonable prices," Ex. 32 at 4, and the "wide licensed selling" of beer and wine. *Id.* at 2-3. The Legislature capped the return on state stores sales to assure that in pursuing greater revenue (not reduced consumption) the LCB would not raise prices too high. RCW 66.16.010(1). (Note that the same RCW section indicates that when prices have been pushed up, as by a surcharge in the current biennium, it has been to raise revenue, not reduce consumption. And if the Legislature thought demand was elastic, it could not have expected to increase revenue by raising price.)

In one of its earliest reports, the LCB boasted that it had achieved price reductions, Ex. 412 at 7, and a year later proclaimed it was "selling liquor at prices as low or lower than any in the country." Ex. 416 at 5. The evidence will show that Washington's mark-ups on wine in state stores remain low by control state standards. In 1939, the LCB found "that *increases* in liquor taxes and the resultant higher costs are *not* conducive to proper control." Ex. 429 at 2-3 (emphasis added); *see Nat'l Ass'n of Motor Bus Owners v. Brinegar*, 483 F.2d 1294, 1311 (D.C. Cir. 1973) ("As a contemporary administrative interpretation of a law entrusted to the [agency's] administration, the regulations are entitled to great weight in court.").

More recently, the Legislature defined the "public interest" as including "efficient" and "competitive" distribution of beer and devotion of distributors' "best competitive efforts and resources to sales." RCW 19.126.010(1) (revised 2003). Hardly a call for less competition and

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lower sales! Indeed, the Legislature specified that a "wholesale distributor shall exert its best efforts to sell" and "merchandise" beer. RCW 19.126.030(4). (That same year the Legislature removed the LCB's exclusive control over strong beer. 2003 Wash. Laws, Ch. 167.) In 2004, at the request of the Board, the Legislature modified the price posting regime to assure that advance disclosure of future prices would not lead to (at least) conscious parallelism and higher prices. 2004 Wash. Laws, Ch. 269 ("SB 6737"). No concern was expressed as to the possibility that the lower prices would cause increased consumption.

It was not until 1995 (decades after most of the restraints had been adopted) that the wholesalers tried to dress up the restraints by drafting language vaguely stating that the State seeks "to promote the public's interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption." RCW 66.28.180(1). But this does not say that the restraints were intended to drive up prices to reduce consumption. Even if the wholesalers believed in such a purpose, they could not have proposed it explicitly and expected adoption. And the Board did not understand the 1995 language to work any change with respect to either satisfying overall demand or increasing prices to reduce demand. As discussed below, the Board never considered either prices or consumption in reviewing the operation of the restraints. Moreover, the Board has generally held its state store wine prices below those of private retailers to protect consumers from higher prices. In response to a 1981 proposal to increase its wine prices, the LCB wrote, "Consumers would suffer. Right now an estimated 500,000 people . . . choose to buy their wine at state stores because prices are lower." Ex. 60 at 1. Even when state store prices were temporarily pushed upward, in 2005, it was not to reduce consumption but to try to end decades of criticism of unfair competition with private retailers (and perhaps with an eye on this litigation). Even as to products more subject to abuse, spirits and strong beer, the State sets prices without regard to the effect on consumption. Indeed, the State itself runs price promotions, including a Washington Wine Month campaign, grants volume (case) discounts, and emphasizes temporary price reductions. *See* Admitted Fact 22.

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2. The Restraints Were Not Intended to Promote Temperance

The parties generally have stipulated to the admissibility of historical documents to the extent they show that the Legislature or LCB took particular positions or expressed particular concerns. As discussed below, however, defendants have indefensibly abandoned that general approach in some areas. In any event, the parties do not stipulate as to the truth of any underlying matter asserted in these documents.

This history of these restraints makes clear that they were originated or promoted by the distributors to serve their private commercial interests and were not designed to promote temperance (whether by pricing abusers out of the market or otherwise).

Price posting. Before the Liquor Act, a 1933 NRA price code had required brewers and beer wholesalers "to post uniform sales prices," Ex. 412 at 9, and to adhere to them. Ex. 318 at 2. The LCB incorporated the posting rules into its efforts. Ex. 412 at 9. Higher prices to limit consumption, however, were not the objective since, as noted above, in the same report the LCB boasted about price reductions. *Id.* at 7. The current price posting regime began in the 1960s, when wholesalers sought to post their prices as "one way of helping wholesaler licensees to gain the profit margin to which they are entitled." Ex. 33. The LCB granted the wholesalers' petition in 1971, Ex. 454, not for temperance reasons but because the wholesalers association had "reached substantial agreement" with the brewers association. Ex. 43 at 1-2. The outcome, the LCB later concluded, was "in the best interests of beer and wine wholesalers." Ex. 49 at 3.

30-Day Holding of Prices. When wholesalers were granted their request to post prices, there was no minimum time they had to hold them once effective. Ex. 454 at 2. In 1982, WBWWA asked for and received a 30-day hold period from the Board. Ex. 61. The LCB said the purpose of posted prices was so that retail licensees "are treated equally by the seller," *id.* at 1, and to allow the "retailer an opportunity to pass *discounts* on to the customer." *Id.* at 3 (emphasis added). This change, which hardly bespeaks reduction of consumption, was "due to the request of the industry." Ex. 66. No intent to limit alcohol consumption was ever mentioned.

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Quantity Discount Ban and Uniform Prices. Uniform pricing was part of the NRA price code that the LCB borrowed for producers, Ex. 412 at 9, a reflection of the 1930s view of "fair" competition, and the quantity discount ban was a corollary to uniform pricing. Ex. 417 at 1. Again, neither temperance nor high prices was mentioned. When in 1971 the wholesalers achieved their wish to post prices, the old NRA rules of uniform pricing and the quantity discount ban became equally applicable to them as well. Ex. 38 at 2.

10% Minimum Mark-up. In 1957, the LCB adopted a rule prohibiting sales below cost. A later memorandum explained that "[t]he present language is in the regulations because of pressure from brewers and wholesalers." Ex. 53 at 2. In 1986, the industry told the LCB it wanted a mandatory percentage mark-up over cost. Ex. 72 at 4-6. LCB minutes explain why:

> [A]t the March 13 meeting, several members representing various tiers of the liquor industry were present. Most spoke against acquisition cost, *unless a specific percentage was added to the language.* Industry members felt that if their competitors could sell at acquisition cost, some of them would be put out of business *due to increased competition. . .*

Ex. 76 at 1 (emphasis added). Even though the "staff still believe[d]" that an acquisition cost standard was "the best solution," an industry member in attendance proposed the 10% figure and "Board Member Hannah suggested that the language be changed to. . . acquisition cost plus ten percent." *Id.* at 2-3.

Credit Ban. After Prohibition ended, brewers and wholesalers extended retailers large credits to allow them to quickly restore their inventories, and some brewers and wholesalers then used that leverage to seek exclusive dealing arrangements. Ex. 412 at 9. The LCB then adopted the credit ban. In 1980, the federal government set a standard of thirty days credit on alcoholic beverages. 27 CFR 6.65, 45 FR 63251 (1980). In 1988, the LCB saw no temperance or other policy reason for retaining its old credit ban and chose not to oppose its repeal. Ex. 82. WBWWA successfully defeated the proposal to adopt the federal rule in Washington. *See* Ex. 84 at 1 ("we are in the fight of our lives to maintain the cash law").

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Delivered Pricing. The current requirement that a retailer pay a delivered price (even when it picks up the goods from the wholesaler) arose out of a Teamsters strike in 1971. Because wholesalers could not deliver with their drivers on strike, the wholesalers' association petitioned the LCB to allow retailers to come to the wholesalers' premises (a so-called "platform delivery") but asked that the retailers nonetheless pay the "delivered price" (in essence, paying for freight twice). Exs. 45 at 4, 46 at 4. Again, no temperance purpose was involved. It was not even admitted that the intent was to increase prices to consumers, much less to do so by enriching distributors.

Central Warehousing Ban. For years, the LCB allowed retailers to warehouse, with no adverse effect on temperance. In 1942, it authorized retailers to have an "additional storage facility away from [their] licensed premise[s]" and for wholesalers to "make deliveries of beer and/or wine to the specified additional storage facility." Ex. 430. In 1971, when obtaining delivered pricing, the wholesalers made sure delivery could be made only at the wholesaler's dock or the retailer's selling premises. Exs. 45 at 4, 46 at 4; *see also* Ex. 481 at 3. In 1984, the wholesalers achieved an explicit ban against warehousing by retailers because they "wanted to make certain large chain stores could not set up their own warehouse and distribution systems for their respective stores." Ex. 130 at 1 (emphasis added).

In 1995, Washington wineries petitioned for the ability to ship their own wine from bonded warehouses directly to retailers (in essence giving retailers a warehousing option). The wholesalers objected. The LCB told the Wine Institute and the WBWWA to get together and reach an agreement. Ex. 138 at 6. An agreement was struck limiting wineries to shipping no more than 2,000 cases a year to all retailers in the aggregate, and the LCB rubber-stamped it. Exs. 144 at 1 ("The language in this filing has been agreed to by all sides"), 145 at 4. Limiting alcohol consumption or abuse was never mentioned.

Ban on Retailer-to-Retailer Sales. This restraint was added by statute in 1937. Sess. Laws Wash. 1937 chap. 217 § 1 (23H). No relevant legislative history has been found.

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Certainly the Costco business model, where small retailers would regularly buy from a licensed large retailer, did not exist in 1937. No temperance purpose for allocating all retail customers to licensed wholesalers, to the exclusion of a licensed retailer, appears in the history or in logic. If the purpose of the now-abandoned three-tier system were to avoid manufacturer control of retailers, allowing retailers to sell to each other could only further that objective.

The 1995 Statute. The price posting, uniform pricing, quantity discount ban, 10% mark-up, and delivered pricing restraints were not put into statute until 1995. In early 1995, the LCB considered whether to do away with price posting, as had occurred in Oregon following *Miller*, Ex. 118 at 1, and the LCB did a survey showing that most other states no longer had price posting. Ex. 121 at 1 (only "[t]en states require posting" by both the supplier and the wholesaler, and only five do it for both beer and wine). But in March 1995, in response to that threat and a possible antitrust lawsuit, the following occurred over 48 hours:

- LCB's Carter Mitchell called WBWWA to say that the Board "want[s] to consider" putting the posting regulations into statute to help deal with the lawsuit threat. Ex. 125 at 2.
- The WBWWA gave a green light, *id.*, and drafted an "intent" section that now appears at RCW 66.28.180(1). Ex. 133 at 1 ("WAIT TILL YOU SEE THE LANGUAGE WE DRAFTED FOR THE INTENT SECTION").
- Mitchell and the WBWWA lobbyist jointly testified on the hastily drafted amendment in a three-minute State Senate committee hearing, telling the committee that price posting "has been questioned [on] whether or not it exceeds statutory authority" and that the amendment was simply intended to

> take our rules that have been in existence for several years – many years – and put those into the Revised Code of Washington so there is no question that indeed they do comply with the statute...

Exs. 127 at 4 309. "It does codify some WACs . . . and we . . . are comfortable with them being put into statute." *Id.*

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That was the sole evidence of legislative intent – a simple adoption of the LCB rules with no discussion at all of temperance. The 1995 statute simply perpetuated the previous restraints and adopted whatever purposes they had. Those purposes did not include the reduction of consumption through state-enforced higher prices.

3. The Most Reasonable Inference From the Restraints Does Not Satisfy the Twenty-first Amendment

Defendants contend that the Court can infer purpose merely from the fact that the restraints inflate prices and costs for some retailers. But even without the history summarized above, the "self-evident purpose [of the restraints] is not to protect the public from the evils of the demon rum, but to preserve the high standard of living of those who sell it." *Battipaglia v. New York State Liquor Authority*, 745 F.2d 166, 180 (2d Cir. 1984) (Winter, J., dissenting); *see* 1 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 217, at 309 (1997) ("the dissent's position is more consistent with *Midcal*"). This is the most logical purpose of raising prices received by wholesalers. Nothing on the face of the restraints or their histories shows any intent by the Legislature to affect consumption through pricing or that the hope of incidental effects on abuse was a rationale for penalizing moderate users of alcohol.

Even if inference could be enough to establish an intended purpose for the restraints, the lack of fit and contradictions discussed below create competing inferences. Many of the State's actions and policies directly conflict with the proffered goals of raising liquor prices and reducing consumption. If the Court is to infer that because the restraints result in increased prices that the State intended the restraints to reduce consumption, then the Court must equally infer that for those restraints and the many other state actions that actually decrease prices or increase access, the State intended to promote consumption. Defendants' inference approach proves nothing. As one District Court noted in response to the argument that it did not matter how many holes the state itself had drilled in the dike as long as it had one finger closing off (even more completely than here) one hole:

> The Court finds that there is no temperance goal served by the statute since Texas residents can become as drunk on local wines or on wines of large out-of-state suppliers

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> able to pass into the state through its distribution system, and available in unrestricted quantities, as those that, because of their sellers' size or Texas wholesalers or retailers' constraints, are in practical effect kept out of the state by statute.

Dickerson v. Bailey, 212 F.Supp.2d 673 (S.D. Tex. 2002), incorporating 87 F.Supp.2d 691, 710 (2000), *aff'd*, (5th Cir. 2003).

For example, the defendants' initial offer of a state purpose, protecting small retailers, was at least factually accurate in that the restraints reduce prices and costs for those favored retailers. Defendants' experts will agree that the requirement that wholesalers charge a uniform delivered price subsidizes the small and inefficient retailers. The problem now is that, according to defendants' current theory, that increases consumption for consumers served by those retailers, often the smallest but most convenient to minors and drivers. *State of Kan. ex rel. Stephan v. Lamb*, 1987 WL 12158, *3 (D. Kan. Feb. 26, 1987) (state restraints promoted "proliferation of retail liquor outlets" and higher prices on other products might have led to increased consumption of beer); *see TFWS II*, 325 F.3d at 238 (increasing the number of small retailers could increase consumption).

C. Defendants' Fallback Purposes Add Nothing

"Orderly markets" is devoid of content, and defendants' own personnel, like the courts, have no idea what it means. *Bainbridge v. Turner*, 311 F.3d 1104, 1115 (11th Cir. 2002) ("as for 'ensuring orderly markets,' we are not sure what that phrase means"). Board Member Ing will concede that without these restraints one could "still have an orderly procedure." The most guidance we have is the State's circular conclusion that an orderly market system is one "that serves state interests in preventing alcohol abuse or evasion of taxation" or discourages "organized crime" or the creation "of incentives to encourage alcohol abuse." Ex. 313 (CA/WA Amici Brief at 5).

Whatever "orderly" may entail, it is not synonymous with anticompetitive. The Washington Supreme Court construed the Washington Legislature's call for "fair, efficient, and competitive distribution of" beer as "ensuring orderly market conditions." *Mt. Hood Beverage Co. v. Constellation Brands, Inc.*, 149 Wn.2d 98, 114, 63 P.3d 779, 788 (2003). Efficiency and competitiveness are hallmarks of antitrust, not anathema to it. *See Jetro Cash & Carry*

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Enterprises, Inc. v. Food Distribution Center, 569 F. Supp. 1404, 1419 (E.D. Pa. 1983) (an orderly market is one "where forces of supply and demand may reign supreme"). Thus, ensuring orderly markets adds nothing.

Now the pretrial order suggests that defendants have added a concern with tax collection and resurrected the allegation of protecting small retailers. Because lower sales mean lower tax revenues, it is hard to see that contention as anything but a self-inflicted wound. And defendants cannot possibly explain away the contradiction between saying they want to drive prices up a small amount to reduce consumption by most consumers and then saying they want to lower them a small amount for some consumers so that they can consume more. Defendants will not introduce any proof that the modern free market economy would not get adequate supplies of wine and beer to consumers who frequent small or even remote retailers, just as that competitive market gets them everything from oatmeal to latte machines.

The defendants' difficulty in finding a Twenty-first Amendment purpose results from the awkward fact that the restraints protect the concentrated and powerful wholesalers from the rigors of competition. *See* Ex. 313 (CA/WA Amici Brief at 1) ("from a high of over 20,000, there are now fewer than 400 liquor distributors and wholesalers, and their typical retail store customer has only about fifty wines available out of the more than 10,000 produced in this county"); *see also* Washington Wine Institute's Amici Brief in Response to Defendants' Response to Costco's Motion for Partial Summary Judgment on Costco's Direct Shipping Claim at 3-4 (Dkt. No. 109) (wholesalers do "not serve the needs of many Washington wineries"). The Twenty-first Amendment "was plainly designed only to allow the states to legislate against the evils of intoxicating liquors rather than to reward its purveyors," *Battipaglia*, 745 F.2d at 180 (Winter, J., dissenting), and wholesaler protectionism surely does not warrant granting the State's regulatory system immunity from Sherman Act review. "State laws that constitute mere economic protectionism are . . . not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor." *Bacchus*, 468 U.S. at 276.

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V. THE RESTRAINTS ARE NOT CLOSELY CONNECTED TO, AND DO NOT MEANINGFULLY FURTHER, ANY CORE PURPOSE

The lack of fit between the restraints and the alleged core purpose is striking, as is the inconsistency of other state actions with the alleged purpose.

A. If Affecting Consumer Purchasing Decisions Were In Fact the Point, Retail Pricing Would be Directly Regulated and Monitored

The restraints are not imposed on the transaction to the consumer, where the consumption occurs but where reduced consumption would affect a wholesaler's volume. (Nor are many of them imposed on the transaction from the manufacturer, *e.g.*, Admitted Fact 27, where the wholesaler's costs would be adversely affected.) If we are to infer purposes for the restraints from this, the most logical inference is that this system is a welfare plan for wholesalers, paid for by retailers and consumers.

Consumers are the ones that make up consumption rates and abuse statistics, yet on sales to consumers there are no mandatory 10% mark-ups (Admitted Fact 25), no bans on case or other volume discounts or credit, and no requirement of uniform prices. Prices can change frequently (as they do for happy hours and weekly beer or wine sales) and need not be posted with the LCB. Consumers can pay for delivery, or pay less if they pick up the product themselves. They are regularly inundated with happy hour, price promotions, and other advertisements that encourage consumption, which defendants' expert will readily admit are effective in doing so. Private retailers sell wine and beer seven days a week. Admitted Fact 24. And the State has now chosen to open some of its stores on Sunday to increase sales and consumption. In addition, the State allows retail sales directly from producers to consumers without any posting or mandatory markups. Admitted Fact 13.

Twenty years ago, when the Twenty-first Amendment test had not even reached the current level of strictness, the State ended a 10% minimum mark-up requirement at the retail level (which was administrative rather than statutory), where it had a more direct and measurable effect on what consumers pay. As in this case, the District Court held on summary judgment that the restraint was per se, hybrid, and unprotected by state action immunity, but the Court reserved the Twenty-first Amendment defense for trial. At the summary judgment stage, the LCB argued

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that the restraint was protected by the Twenty-first Amendment because it furthered "market stability" and reduction of consumption. (As in this case, the LCB relied largely on the real party in interest, there a large retailers association (the Washington State Food Dealers Association or WSFDA), to defend what purported to be an action in the public interest; the LCB adopted in whole the WSFDA summary judgment brief on the Twenty-first Amendment issue.)

The defendants in 1987 admitted that they had to show that the regulation's effects were "closely related" to the Twenty-first Amendment purposes. WSFDA Brief at 11, *Costco v. Washington State Liquor Control Board*, W.D. Wash., No. C87-66TB (November 30, 1987). They admitted that the federal competition interest is "important." *Id.* at 12. They emphasized that their economist would show that the regulation "will actually accomplish its purpose." *Id.* at 17. And yet, as defendants have admitted, Admitted Fact 25, within months the Board abandoned the regulation rather than try to prove what it agreed it had to prove.

The abandonment of the retail mark-up regulation is compelling proof of the lack of necessity for these less direct (wholesaler and supplier markups do not directly affect retail prices) and doubly less direct (all the other restraints do not even directly affect wholesale much less retail prices) restraints. If driving up the price to consumers were effective in reducing abuse and that method and level of reduction was important to the LCB, it would have tried the 1980s case or at the very least gone to the Legislature after the settlement and asked for a statutory retail mark-up requirement as allowed by the settlement. Ex. 81 at 4-5.

B. Inconsistencies Overwhelm The Post Hoc Litigation Rationale

Only the State sells at retail for off-premises consumption the form of alcoholic beverage, spirits, that was the main concern of Prohibition and of the Washington Liquor Act. If there were a policy to price abusers out of the market through raising prices, the State stores would be the logical and ideal laboratory for such an experiment. But there is no evidence that prices of spirits are set with a view toward optimizing consumption (a concept that the State has never even tried to express quantitatively) or balancing service of overall demand against risk of abuse.

While that is the most fundamental contradiction with defendants' asserted purpose, the State does many things that facilitate, maintain, or increase consumption of not just wine and

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beer but also spirits, and the State has no idea of the extent to which those actions exceed the alleged impact of the restraints. The State *has not*:

- examined whether or the degree to which any increase in consumption has occurred as a result of any actions taken by the State to serve lawful consumption. Admitted Fact 11.
- examined whether or to what degree any reduction of wine or beer consumption that has occurred as the result of the restraints exceeds the increase in consumption from any one or more of the actions the State takes to serve lawful consumption. Admitted Fact 12.
- compared the impact the restraints have on consumption to the impact of efforts to promote the Washington wine or beer industries may have on consumption. Admitted Fact 14.
- determined whether or the degree to which any negative impacts have arisen from allowing Washington producers to sell directly to retailers or from allowing Washington producers to also act as retailers. Admitted Fact 16.
- performed any quantitative analysis of the effect of the termination of the minimum retailer mark-up on retail prices or on overall or abusive consumption. Admitted Fact 26.
- Examined the extent to which overall or abusive consumption of wine, beer, or liquor have been increased by any one of the following:

  temporary price reductions made available to consumers in Liquor Control Board stores;

  volume or case discounts made available to consumers in Liquor Control Board stores;

  quantity discounts obtained by the LCB in its purchases for Liquor Control Board stores;

  credit extended to the LCB on its purchases for Liquor Control Board stores;

  Sunday sales;

  Post-offs in the post and hold system;

  Uniform pricing to small and remote retailers;

  Opening of additional Liquor Control Board stores;

  Licensing of additional retailers;

  Increased focus on merchandising in Liquor Control Board stores;

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Allowing happy hours; or

Allowing retailers to conduct sales and offer volume discounts.

Admitted Facts 15, 17.

We do, however, know a few ultimate facts. Consumption of spirits, with no such restraints, has declined. Consumption of wine has fluctuated, but not generally declined, and is much higher than in many states without the restraints. *See TFWS II*, 325 F.3d at 242.

C. The Restraints Have Not Had a Meaningful Impact on Abusive Consumption, and Defendants Have Not Cared

Defendants cannot make a clear showing that the restraints are "necessary to effectuate the proffered core concern." *Mt. Hood*, 149 Wn.2d at 115, 63 P.3d at 788. A Twenty-first Amendment defense fails where defendants cannot substantiate a close correlation between the challenged restraints and the policies they purportedly serve. This is not the first time that the price/consumption defense has been raised (although the first time was long after most of the restraints had been adopted), and it has never been successful. *E.g., Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 112 (1980) (adopting state court's finding that there was "little correlation between resale price maintenance and temperance"); *see id.* at 112-13 (regulations ineffective at protecting small retailers); *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 39 (1966) (citing study concluding that resale price maintenance had "no significant effect upon consumption"); *State of Kan. ex rel. Stephan*, 1987 WL 12158 at *3 (concluding that the relationship between price and consumption was "inexact" because of "numerous factors involved in making the correlation"); *Rice v. Alcoholic Beverage Control Appeals Bd.*, 579 P.2d 476, 493-94 (Cal. 1978) (concluding that retail price maintenance of liquor does not promote temperance or protect small retailers). In *Lewis-Westco & Co. v. Alcoholic Beverage Control Appeals Board*, the California Court of Appeals concluded that California's price-posting laws were not saved because they did not have a close connection to the same alleged purpose as here:

> [I]t is conjectural at best whether the anticompetitive effect of price posting would trigger higher wholesale prices and consequent higher retail prices so as to cause a perceptible decrease in consumption demands. . . . Such

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> doubtful benefit is inadequate to override the significant objectives of the Sherman Act.

1186 Cal. Rptr. 552, 559 (Cal. Ct. App. 1982) (citations omitted).

As in *324 Liquor*, here there have been "no legislative or other findings" that the restraints are effective. 479 U.S. at 350. Professor Chaloupka will instead say what the Legislature and LCB have never studied or commented on in 70 years--that there is some relationship between prices and consumption and that there might also be some effect on abusive consumption. But "statistically measured but loose-fitting generalities" are not enough. *Craig v. Boren*, 429 U.S. 190, 209 (1976). In *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996), the Court's plurality acknowledged that noncompetitive prices can affect consumption but refused to assume that such prices "will significantly advance the State's interest in promoting temperance." *Id.* at 505; *see id.* at 507 & n.18 (cannot rely upon "speculative assertions about impact on consumption"). And identifying the problem that Professor Chaloupka has not overcome, the *44 Liquormart* Court noted the common sense proposition and evidence "suggest[ing] that the abusive drinker will probably not be deterred by a marginal price increase, and that the true alcoholic may simply reduce his purchases of other necessities." *Id.* at 506; *see TFWS II*, 325 F.3d at 238 ("consumers might respond to higher prices by buying less expensive brands or types of alcoholic beverage").

In fact, because the State does not actively supervise the restraints, as this Court has already determined, defendants' case will be most striking for what defendants *do not know*, rather than what they do know. The State has never determined exactly what it supposedly hopes to accomplish in terms of reducing consumption or abusive consumption, Admitted Fact 4, but in fact has assumed that both are within acceptable ranges even though Washington residents consume twice as much wine per capita as most states. The State *does not*:

- monitor or review actual quantities of beer and wine purchased by consumers from retailers, or the quantities sold by individual retail outlets. Admitted Fact 8.
- generally review whether individual retail prices to consumers encourage purchase and consumption, or affect overall or abusive consumption of beer or wine. Admitted Fact 9.

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- examine, much less re-examine the restraints. *See* Ex. 244 at 14 (Costco's Requests for Admissions Nos. 36, 37).

As explained by the Supreme Court, in the absence of such active supervision, "there is no realistic assurance that [hybrid] anticompetitive conduct promotes state policy." *Patrick v. Burgett*, 486 U.S. 94, 101 (1988).

VI. THE BALANCE STRONGLY FAVORS THE FEDERAL INTERESTS

Even if defendants manage to establish a purpose for the challenged restraints that falls within the core concerns of the Twenty-first Amendment and that the restraints are effective at accomplishing that purpose, the Twenty-first Amendment then requires a balancing of the State's interest in the restraints against the federal interest. *TFWS I*, 242 F.3d at 213. This is far from abject deference. In *Miller v. Hedlund*, for example, the trial court on remand readily concluded that the anticompetitive effects of post-and-hold and volume discount restraints "is not outweighed by an important Twenty-First Amendment interest." 717 F. Supp. 711, 716 (D. Or. 1989). Defendants cannot point to a single case upholding similar restraints since the evolution of the modern understanding of the Twenty-first Amendment. In fact, in every case we can find in which a court has held, as here, that there is an antitrust violation with no state action immunity, no court has gone on to determine that the state nonetheless established Twenty-first Amendment immunity. More particularly, when the Supreme Court has addressed resale price maintenance, identical in effect to the restraints challenged here, it has never found that such a scheme qualified for Twenty-first Amendment immunity. *324 Liquor*, 479 U.S. at 352; *Midcal*, 445 U.S. at 114. And no court has found that an inadvertent and indirect effect on abusive consumption can outweigh federal interests.

A. The Strong Federal Interests in the Sherman Act and the Supremacy Clause

In *North Dakota v. United States*, 495 U.S. 423 (1990), the Supreme Court found that state temperance interests did not outweigh a mere Department of Defense purchasing policy. Here, the federal interest is much greater. "The preservation of the free market and of a system of free enterprise without price fixing or cartels is essential to economic freedom." *Ticor*, 504 U.S. at 632 (1992). "The Sherman Act has been described as the Magna Carta of free enterprise,

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and Congress exercised all the power it possessed under the Commerce Clause when it approved the Sherman Act." *Miller v. Hedlund*, 813 F.2d 1344, 1352 (9th Cir. 1987) (internal quotations omitted). "Although this federal interest is expressed through a statute rather than a constitutional provision," *Midcal*, 445 U.S. at 111; *see Ticor*, 504 U.S. at 632 ("national policy of such a pervasive and fundamental character"), the Sherman Act was intended to further the purposes of the Commerce Clause by "establish[ing] a regime of competition as the fundamental principle governing commerce in this country." *City of Lafayette, La. v. Louisiana Power & Light Co.*, 435 U.S. 389, 398 (1978); *324 Liquor*, 479 U.S. at 350. The operation of the Sherman Act through the Supremacy Clause is thus integral to and certainly no less important than the "dormant" Commerce Clause, and as with the Commerce Clause in *Granholm* the Supreme Court has recognized that the "Twenty-first Amendment does not in any way diminish the force of the Supremacy Clause." *44 Liquormart*, 517 U.S. at 516.

B. The State Endorses the Importance of the Sherman Act

Except in this case, the State agrees that the Twenty-first Amendment must not be construed to interfere with "important state interests in the free flow of commerce." Ex. 313 at 12 (CA/WA Amici Brief at 2). Any elsewhere the State endorses the importance of the Sherman Act, directing that it guide the interpretation of the State's own antitrust provisions, RCW 19.86.920, and that the Attorney General's Office enforce both the "state and federal laws that protect consumers and businesses from anticompetitive practices." www.atg.wa.gov/consumerintro.html. Attorney General McKenna recently told the Antitrust Modernization Commission that the "National Association of Attorneys General has consistently opposed legislation that weakens antitrust standards for specific industries because there is no evidence that such exemptions would either promote or serve the public interest." http://www.amc.gov/commission_hearings/pdf/050715_McKenna-Wash._AG-Reg_Indust.pdf.

C. The Restraints Directly and Substantially Damage Competition and Consumer Welfare

In the defense case, Professor Leffler will explain the direct and substantial damage done by the restraints, individually and as a whole, to competition, the marketplace, and many

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consumers, and will address the distorting impact of the restraints on price, efficiency, output, and demand. Liberated by the summary judgment ruling from the burden of contending otherwise, defense experts will at least partially agree.

D. Washington Tempers Temperance in Furtherance of Objectives Much Less Substantial than the Sherman Act

The State can increase per capita consumption, increase sales, subsidize small and remote retailers, and engage in practices prohibited by the restraints but claims that it can reconcile those conflicting actions and their effect on abusive consumption. If that is true, then the State can also find a way to incorporate the substantial federal interest in enforcing the Sherman Act. And the failure to apply the challenged restraints to the State stores and to pursue reductions in consumption whenever reasonably possible suggests a "limit on the substantiality of the interests [the State] asserts" in comparison to the federal interest in competition. *Capital Cities Cables, Inc. v. Crisp*, 467 U.S. 691, 715 (1984) (selective approach of Oklahoma's liquor advertising laws). If the interests were as important to the State as defendants contend, the State would have supervised the restraints and analyzed their effects, which they have failed to do entirely.

These "'unsubstantiated state concerns' under the Twenty-first Amendment are not sufficient to trump the 'goals of the Sherman Act;' a state must demonstrate that its liquor regulatory policies directly serve the interest it proffers under the Twenty-first Amendment.'" *TFWS I*, 242 F.3d at 212, quoting *Midcal*, 445 U.S. at 114. The unproven and unfocused interests asserted by defendants here cannot "prevail against the undisputed federal interest in a competitive economy." *Midcal*, 445 U.S. at 114; *see also Lewis-Westco*, 186 Cal. Rptr. at 559 ("[T]here is little evidence to suggest that price maintenance legislation significantly contributes to reduced consumption of alcohol. Such doubtful benefit is inadequate to override the significant objectives of the Sherman Act.").

Professor Tribe, whom the State itself relied upon in its Twenty-first Amendment brief in *Granholm*, Ex. 313 (CA/WA Amici Brief at 7-8), notes that the Amendment has been subject to a gradual narrowing, largely limiting it to regulations involving the importation of alcohol. Laurence H. Tribe, *American Constitutional Law* § 6-27 (3d ed. 2000). The Twenty-first

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Amendment interests are not as clear and close once a state, like Washington, allows liquor to enter its borders and commits to satisfying overall consumption and, with respect to wine and beer, to do so through private entities operating generally within the free market economy. In that situation, a state's Twenty-first Amendment powers are particularly circumscribed by the federal interest in the promotion of competition. *Id.*

E. Obvious Less Restrictive Alternatives Exist

Even if one or more of the restraints had a sufficiently close relationship to a state purpose within the core concerns of the Twenty-first Amendment, defendants must prove that their intended purpose "cannot be adequately served by reasonable nondiscriminatory alternatives." *Granholm*, 125 S. Ct. at 1905. In light of all the other ways to raise prices or reduce consumption, including subjecting wine to the state store monopoly or suspending the LCB's own actions that increase consumption, it is impossible to imagine what defendants will attempt to prove. *See State of Kan. ex rel. Stephan*, 1987 WL 12158 at *3 ("no evidence before the court...demonstrates how the minimum markup [pricing] system does anything ... other than to make the retail liquor prices substantially higher than they should be;" "the [temperance] goal of the instant statutes cannot be taken seriously given the absence of a minimum prices system"). As the Second Circuit noted in dealing with a similar argument:

> [G]iven the broad police powers of the state to regulate the marketing of dangerous commodities, effective public health measures other than affording . . . manufacturers a cartel are ubiquitous and far more obvious than . . . complex [anticompetitive] arrangements . . . enforced by . . . statutes. For example, if limiting sales of cigarettes by higher prices is chosen as a public health measure, a flat . . . tax on each cigarette sold would alone do the trick.

Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 231 n.25 (2d Cir. 2004).

Accordingly, until just recently defendants had candidly admitted that they would not try to prove that any of the restraints are "necessary to the accomplishment of State policies." Ex. 228 at 10 (Interrogatory Answer No. 11). On the eve of trial, however, defendants have suggested that they dispute whether reasonable alternatives are possible, but all that they have hinted to date is that one obvious method, increasing taxes to offset the savings to consumers from eliminating the restraints would be so unpopular that legislators would reject it.

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This disturbing suggestion ignores the fact that the people remain paramount in Washington and thus get to decide what potential power under the Twenty-first Amendment to exercise. *See* Washington Constitution Art. 1, Sec. 1; *see also id.* Art. 2, Sec. 1. It is offensive for defendants to suggest that the Legislature would seek to accomplish its alleged objective in a way that would hide both the objective and the price impact from the people, and especially offensive when defendants hypocritically cite the lack of uproar from the people as an endorsement of the restraints. Such an argument has no place in the Twenty-first Amendment analysis. If a state wants to appeal to federalism and state power, it cannot do so in the name of hiding the ball from its own citizens. Instead, as the Supreme Court has bluntly held, "[s]tates must accept political responsibility for actions they intend to undertake . . . Federalism serves to assign political responsibility, not to obscure it." *Ticor*, 504 U.S. at 636.

F. Defendants' Argument Proves Too Much

Every state is concerned with temperance. Every per se antitrust violation raises prices or reduces output. Defendants argue that those two facts without more establish a defense under the Twenty-first Amendment. If so, there can be no Sherman Act preemption of liquor regulations, and every decision of the Supreme Court and the lower courts in this area has been wrongly decided.

But of course the appropriate rule is exactly the opposite. The Twenty-first Amendment protects alcohol regulation *by the state*, not private commercial enterprises. The Court has already found that the restraints do not involve only acts of the "sovereign itself" because the "restraints reduce price competition while leaving price determinations to private actors, which the state enforces without reviewing the prices for reasonableness." First Antitrust Order at 14 n.5. Particularly where such a Sherman Act violation has been found, the Court should find that the restraints are unprotected by the Twenty-first Amendment.

VII. EVIDENTIARY ISSUES

Defendants (in Exhibit A of the Pretrial Order) have raised numerous relevance objections to three general categories of Costco exhibits:

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First, defendants object to documents that discuss their participation in or countenancing of promotion of consumption. This evidence belies defendants' claims that the challenged restraints were intended to dampen consumption and are effective at doing so. The challenged documents relate to:

- Promotional and discounting practices on spirits in state stores (Exs. 5, 242);
- Promotional activity allowed in Washington but not in some other states (Exs. 3, 4, 31, 87,), and considerations that led the State to reject greater restrictions on alcohol promotion (Exs. 87, 88 at 2, 89, 90, 91, 92, 129, 163, 165);
- State stores' promoting of wine and undercutting of wine prices of private retailers (Exs. 149, 153 at 1 (last para.) & at 2 (third para.), 155, 169 at 2-3, 170 at 3, 180); and
- Promotional activity by distributors that Costco contends is financed and encouraged by the challenged restraints (Ex. 176); mandated in supplier-distributor contracts filed with the LCB under the price posting system (Exs. 298-304); or encouraged through interlocking supplier-distributor relationships permitted by the LCB (Ex. 198 (last page)).

Second, defendants object to documents authored by persons outside the LCB that bear on the origin and effects of the challenged restraints, even though the Court must evaluate such information in assessing alleged purposes and fit. The challenged documents include:

- An FTC discussion of competitive effects of some of the restraints (Ex. 55) that led to a change in one of them (Ex. 56);
- Virtually every document that discusses the input of WBWWA, as well as others, in the formation or maintenance of the restraints (Exs. 33, 80 (pp. 3-4), 84, 85, 86, 98 (pp. 4-5), 103, 104 (p. 3), 107 (p.2), 115, 118 (p. 1), 125, 126, 128, 133, 134, 150, 187, 199, 220, 222, 223, 319, 320);
- Distributor markups and how the restraints enable distributors to monitor each others' prices and markups. (Exs. 109, 158, 159, 162 (pp. 4-5), 186, 254-268, 270-297, 308 (last several pages discussing wholesaler markups and bottlenecks));
- Elimination of the mandatory 10% mark-up for retailers (Ex. 81);

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- The transcript of the sole legislative hearing on the purposes of the 1995 statute that put many of the restraints into statute (Exs. 127, 309);
- Documents relating to defendants' claims that the restraints serve the collection of taxes or that the State seeks to raise prices (Exs. 172, 182, 183, 208 at 1-2, 313).

Lastly, defendants dispute that the bonded warehouse restraint is part of the central warehousing ban and thus object to every document that discusses "bonded warehousing" (Exs. 130, 131, 137, 138 (pp. 5-6), 139, 140, 141, 144, 216).

VIII. CONCLUSION

Defendants ask the Court to conclude that the Legislature intended to enrich the distributors in order to slightly reduce consumption by most consumer a few percentage points on average. This purpose was never expressed, never intended, has not been effective, and was never necessary or justified under the Twenty-first Amendment. The Court should rule that these anticompetitive restraints are not protected by the Twenty-first Amendment and are preempted and unlawful.

DATED: March 15, 2006.

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DECLARATION OF SERVICE

I declare that on March 15, 2006, I caused to be served upon counsel of record, listed below, via email, an electronic true and correct copy of the foregoing Costco's Trial Brief to the following:

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED: March 15, 2006 at Seattle, Washington.

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